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Message Text

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ACTION EB-11

INFO OCT-01 EUR-25 EA-11 ISO-00 SPC-03 AID-20 NSC-10

RSC-01 CIEP-02 TRSE-00 SS-20 STR-08 OMB-01 CEA-02

CIAE-00 COME-00 FRB-02 INR-10 NSAE-00 XMB-07 OPIC-12

LAB-06 SIL-01 L-03 H-03 PA-04 PRS-01 USIA-15 DRC-01

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R 260930Z NOV 73
FM AMCONSUL HONG KONG
TO SECSTATE WASHDC 8803
INFO AMEMBASSY LONDON
USLO PEKING

C O N F I D E N T I A L HONG KONG 11790

DEPARTMENT PASS TREASURY AND FEDERAL RESERVE

E.O. 11652: GDS
TAGS: EFIN, CH, UK
SUBJ: STERLING GUARANTEES, STERLING HOLDINGS AND PRC EXCHANGE RESERVE MANAGEMENT

REF: HONG KONG 9990

1. ACCORDING TO HKG SOURCE, IT IS ON VERGE OF SIGNING NEW STERLING GUARANTEE AGREEMENT WITH UK. ISSUE WAS ORIGINAL 89 PERCENT MINIMUM STERLING PROPORTIONS (MSP) WAS BASED BOTH ON HKG AND COMMERCIAL BANK HOLDINGS WHICH MADE UP ROUGHLY EQUAL PARTS OF BASE FOR CALCULATING GUARANTEE. BANKS WERE ALREADY PULLING OUT BY SELLING STERLING FORWARD SEVERAL MONTHS BEFORE SEPT. 24 DEADLINE. THEY HAVE NO INTEREST IN MOST RECENT UK PROPOSAL. THEREFORE, ACCORDING TO ORIGINAL UK PROPOSAL, NON-STERLING CURRENCY ASSETS WOULD HAVE TO BE SOLD TO BRING THEM DOWN TO 11 PERCENT OF REDUCED BASE. HKG RESISTED AND HAS NOW APPARENTLY SUCCEEDED

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IN PERSUADING UK TREASURY (WHOSE REPRESENTATIVE PASSED THROUGH

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LAST WEEK) ACCEPT ITS POSITION WHICH IS TO RETAIN SAME ABSOLUTE LEVEL NON-STERLING RESERVES. THIS WOULD HAVE EFFECT OF PUSHING MSP BELOW 80 PERCENT IN AGREEMENT COVERING SIX MONTH PERIOD SEPT. 24 - MARCH 23.

2. SINCE BANKS HAVE GOTTEN RID OF MOST THEIR STERLING, HONG KONG ECONOMY HAS PROBABLY TRANSFERRED ALMOST 300 MILLION POUNDS SINCE JULY MOSTLY INTO DOLLARS AND LESSER EXTENT DEUTSCHEMARKS AND YEN. THIS OPERATION HAS BEEN FACILITATED, ACCORDING TO SAME INFORMANT, BY PRC PRACTICE OF TAKING ITS LARGE B/P SURPLUS WITH HK ENTIRELY IN STERLING. COMMERCIAL BANKS STERLING HOLDINGS NOW SO LOW THAT THEY MUST NOW SELL DOLLARS TO MEET THIS NEED. THEREFORE, USING PRE-SEPT. 24 BASE, MSP HAS SLIPPED EFFECTIVELY FROM 89 PERCENT PROBABLY TO ABOUT 50 PERCENT.

3. FINALLY, IF AS APPEARS LIKELY, HK DOLLAR REMAINS ATTACHED TO US DOLLAR AND NORMAL BANKING RELATIONSHIPS ARE ESTABLISHED WITH US, PRC MAY BEGIN SEND MUCH OF ITS US BILLION DOLLAR SURPLUS WITH HK DIRECTLY TO NEW YORK AND REDUCE ITS RELIANCE ON LONDON. SHIFT WOULD HAVE ONLY MARGINAL EFFECT ON BOTH FINANCIAL CENTERS GIVEN THEIR VOLUME OF TRANSACTIONS.
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